

Effective Use of International Environmental Financial Instruments

Kenneth King

Assistant Chief Executive Officer
Global Environment Facility

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INTRODUCTION

1. Finance was a major issue at the United Nations Conference on Environment and Development held in Rio in 1992 and in the follow up in the Commission for Sustainable Development. The Global Environment Facility (GEF) has been the only new funding mechanism to emerge out of the Rio process; it became the financial mechanism for the two conventions signed at Rio (the Convention on Biological Diversity and the United Nations Framework Convention on Climate Change) and has since been requested to become the financial mechanism for the Stockholm Convention on Persistent Organic

Pollutants. GEF also finances actions to phase out ozone-depleting substances in economies in transition, to minimize environmental degradation in international waters, and to combat land degradation. Less well known perhaps is the fact that as a result of its finance for global environmental concerns and the linkage between those concerns and local environmental issues, GEF has also become a major source of finance for Agenda 21. In some areas of Agenda 21, GEF is the most significant source of finance.

2. GEF supports the protection of the global environment in a sustainable development framework. It is therefore fully supportive of the World Summit on Sustainable Development scheduled for August and September 2002 in Johannesburg. Part of that support is its sponsorship of a series of Roundtables on critical environmental and sustainable development issues. In partnership with international and regional organizations, national governments, and NGOs, GEF sponsored thematic roundtables on sustainable energy, on forests, and on land, water, and food security. The first of two ministerial roundtables on “Financing for the Environment and Sustainable Development” was convened in Monterrey, Mexico and the second will be held in Bali, Indonesia. Panels of experts from around the world will participate, and recommendations emerging from the Roundtables will be fully integrated into the World Summit process.

3. The Rt. Hon. Clare Short, UK Minister for International Development, and H.E. Mohammed Valli Moosa, South Africa’s Minister of Environment, are chairing the roundtables on finance. The first session, in Monterrey, noted the “paradigm shift” in the thinking in the international community as efforts have focused on achieving sustainable development with the primary goal of eradicating poverty. The Millennium Development Goals, approved by government leaders at the Millennium Summit in September 2000, framed that new paradigm and this was carried into the Monterrey Conference on Financing for Development in March and will be carried forward into the Doha trade round for development as well.

4. The GEF Ministerial Roundtables on Finance -- comprising ministers of development cooperation, finance, and environment together with heads of international organizations -- addressed the means to *generate* the funding that will be required to ensure that environment is truly integrated into the Millennium Goals. What I would like to turn to here is the other end of the equation: the effective *use* by recipient countries of the international environmental financial instruments that could be so funded. For the GEF, these recipients are developing countries and countries with economies in transition.

5. Our experience with financial instruments can be evaluated according to a number of principles that have their origin in the GEF Operational Strategy.

- (a) **Accessibility.** In recognition of the country-driven nature of GEF projects, which respond to national priorities, it has been necessary to use a variety of modalities and funding sizes in order to provide the greatest number of countries and actors with the possibility of accessing GEF funds for eligible

purposes. GEF commitments range over almost four orders of magnitude -- from about \$10,000 (e.g., for a small grant to an NGO) to more than \$50 million where a country is willing to make the commensurate commitments and provide substantial cofinancing.

- (b) **Effectiveness.** Country level ownership and performance is an important determinant of project success and cost-effectiveness, and for this reason GEF targets financial support in a variety of ways, from foundational capacity-building to ways of removing barriers to the adoption of efficient “win/win” solutions.
- (c) **Linkage.** Linking global environmental concerns to local concerns and livelihoods through project design and financial instruments is a way to build in ownership at multiple levels -- thereby building partnerships, attracting other sources of funding, providing extra incentives for diligence in execution, and increasing the chances of project success and sustainability of environmental benefits.
- (d) **Sustainability.** Sources of financing that can be maintained after project completion are critical for the sustainability of environmental benefits.
- (e) **Leverage.** Catalytic action and leverage, particularly of private sector resources, remains a major objective and one that is critical to long-term cost-effectiveness. Catalyzing institutional changes can best be done through long-term partnership with a range of organizations – countries, private sector, NGOs, and development agencies.

6. As a learning-based institution, GEF supports innovative financial instruments, evaluates its experience, and facilitates the replication of successes. Below, I have illustrated these important features of international environmental financial instruments, using examples drawn from among the 800 projects and 1,800 small grants financed by GEF.

ACCESSIBILITY

Small grants

7. Grant size is an important aspect of accessibility. The GEF Small Grants Program, currently being implemented in 61 countries, is based on the rationale that global environmental problems can be addressed more sustainably when local communities are actively involved. To make grants accessible to such groups, it was necessary to experiment with small strategically targeted projects -- some grants can be as small as \$10,000. The Second Overall Performance Study of the GEF¹ confirmed the conclusions of the Second Independent Evaluation of the Small Grants Program (1998) that the program occupies a unique and valuable niche within GEF and that it would be appropriate to expand it so that it is accessible in all eligible countries. One example

¹ *The First Decade of the GEF*. Second Overall Performance Study, Global Environment Facility, January 25, 2002.

among the 1,800 small grants projects supported by the GEF to date (one that I visited last year), was a project for protecting nesting avifauna saline waters of Thyna-Sfax in Tunisia. A GEF grant of \$39,000 was made available on the advice of the local Small Grants Committee, and this helped a local NGO in partnership with a number of government and other organizations to address threats to biodiversity by creating buffer zones, re-vegetating to separate industrial areas from conservation areas, relocating dumping areas and roads, controlling access and usage, enclaving dykes, and designing tourist circuits.

Micro-finance

8. Small investments can also be made in the context of an overall program that provides support for micro-finance. One such project is GEF's energy services delivery project in Sri Lanka, which is being implemented by the World Bank and which was recently reviewed. One of the financial innovations of the project was the partnership with micro-finance institutions to provide (i) the outreach for solar home system consumer loans; and (ii) market development in collaboration with private dealers. One micro-finance institution has now up-graded to participate as a credit institution to access the credit line directly.

Medium size grants

9. Higher up in terms of financial size are the Medium Size Projects of up to \$1 million that can be approved under expedited procedures. These form an accessible bridge between the community-based small grants and micro-finance on the one hand and larger projects that address national and regional initiatives on the other. A recent evaluation of Medium Size Projects found clear indicators of progress in terms of capacity development, innovation and use of new methodologies, awareness raising, and prospects for sustainability. Two examples of the accessibility of this instrument, among the 121 such projects funded to date, are (i) a project for South Africa to help preserve biodiversity in Namaqualand through training local people and involving them in park development and conservation issues as an alternative to grazing, and (ii) support for the electricity commission of the same country to evaluate the possibility of introducing solar thermal electric technologies as electricity generation options in the region.

Programmatic approaches

10. Beyond the normal range of project financing lies the programmatic approach, whereby donors such as the GEF commit much larger amounts on a sustained multi-year basis. This financial instrument can support those countries that have made major long-term commitments to environmental protection. It can be used to phase GEF financial support that is commensurate with major levels of counterpart financing. One example is Brazil's laudable commitment to set aside ten per cent of the Amazon – an area almost the size of France and the largest set aside in the Amazon region. GEF made an initial commitment of \$30 million to a joint program over a four-year period, in a package that included matching funds from the G-7 countries, Brazil, and WWF. The World Bank and WWF also committed themselves to raise \$140 million in public and private sector funds to complete the financing of this program. In other programmatic approaches, GEF is supporting efforts to protect the Danube and Black Sea, is working with ADB to

support China's efforts to combat land degradation in western part of the country, and is preparing to support the creation and transformation of markets for renewable energy in several countries with the World Bank.

EFFECTIVENESS

11. Country level ownership and performance are important determinants of project effectiveness and cost-effectiveness. For this reason, it is necessary to provide financial support for foundational capacity building and for ways of removing barriers to the adoption of efficient "win/win" solutions. In terms of financial instruments, the main challenge is the provision of support to remove barriers in the market that avoid simple subsidies for the products and services themselves.

Finance for barrier removal

12. Finance is provided for the removal of barriers to the adoption of environmentally friendly alternatives that would otherwise be economically viable. The GEF project in China for the removal of barriers to efficient electric lighting products and systems is typical – addressed through technology transfer and public awareness. In another example, the way to overcome barriers to joint ventures with OECD wind manufacturers in one Latin American country turned out to be provision of wind resource mapping, the upgrading of the industrial standards institute to certify the quality of steel and electrical components from local suppliers, and training in maintenance of the new technology. Note that the cost of the wind technology itself would not be considered a long-term "barrier"; subsidies that merely reduce a product's financial cost do not result in sustainable barrier removal.

LINKAGE

13. Project activities that simultaneously address environmental issues and national and local priorities are more likely to be successful, sustained, and replicated because multiple stakeholders will be committed for their individual reasons as well as for the common good. This requires not only ensuring participation of local communities in project design and execution but also creating and sharing of benefits. Examples in the GEF pipeline or portfolio include: biodiversity conservation linked to flood control, as in China's Sanjiang region (ADB); climate change renewable energy projects that also reduce atmospheric pollution, as in Mexico's transport sector (World Bank); projects protecting international waters through protecting the economically vital coastal marine ecosystems, as in Belize (UNDP); and persistent organic pollutant reduction projects that will also address public health concerns, such as those for reducing Caribbean pesticide runoff and for promoting alternatives to DDT for Malaria vector control in Mexico and Central America (UNEP).

Cofinancing

14. Making such linkages effective requires financial instruments admitting, indeed encouraging, cofinancing. Cofinancing is necessary because it helps ensure that the project is adequately funded and because it is an indicator of commitment by the various concerned groups. Financing can be obtained from the following groups:

- (a) The international community -- making (say) a GEF grant in respect of the global or transboundary benefits;
- (b) The country -- securing counterpart financing for the development aspects;
- (c) The implementing or executing agency -- providing loan, grant, or in-kind support through its regular development assistance program; and
- (d) Beneficiaries -- paying for local benefits and ensuring cost recovery for (say) the energy or environmental services delivered by the project.

15. A particularly illustrative example of the range of cofinancing in a GEF project is the *Mountain Areas Conservancy* project in Pakistan, which mobilized resources from government, UNDP, local NGOs (\$4 million), local government counterpart contributions, and village funds.

16. GEF is now focusing on its policy of cofinancing much more sharply in terms of the definition of cofinancing and associated concepts; the adequacy of cofinancing in various project types; the stability of cofinancing commitments; and documentation issues -- including for making in-kind commitments itemized, monitorable, and auditable.

Complementarity and incremental cost financing

17. Finance for projects with multiple benefits will have to be complementary with other sources of finance. This complementarity is essential to GEF's having the maximum positive impact on the global environment with the resources at its disposal. It is also critical for its ability to mobilize grant resources from the donor community. Financial instruments that respect this principle act as a guarantee that grant resources are not substituting unsustainably for resources more appropriately mobilized in other ways - including from beneficiaries of economic development and from development cooperation agencies whose core mandate is development rather than global environmental protection.

18. To facilitate complementarity, it is necessary to have a transparent and practical principle for determining the eligible levels of grant financing for any catalytic financial mechanism such as the GEF. The GEF finances those costs that are "incremental," that is, additional to the costs that would have been necessary to achieve the same national and local benefits but without adding the global or transboundary environmental dimension. GEF has defined an approach to incremental costs,² has developed a number of paradigm cases to facilitate the application of the principle for many different project types, and will now complete a framework to expedite discussion and agreement on the costs to be financed with the countries concerned.

19. The variety of innovative project designs means that incremental cost has to be interpreted pragmatically on a case-by-case basis. Here are some illustrations of the concept:

² *Incremental Costs*, GEF/C.7/Inf.5

- (a) Conceptually the easiest cases are substitutions of an environmentally friendly technology or method for another that would be less costly but yield only the national or local economic benefits (for example, the GEF-supported solar-thermal electric project in Rajasthan, which would substitute solar for a fossil fuel power generation). The incremental cost in a case like this is the difference in cost when all fixed and variable costs of the two alternatives (the proposal and its comparator) are taken into account. Although incremental cost financing is easy to appreciate in the abstract, and essential to pursue for the reasons above, there are several practical complexities even in conceptually simple cases like the above: the time value of money, incremental risk associated with a new technology or method, the asymmetry of available information, the uncertainty of counterfactual baseline data, and the financial incentives for design and operation to which such a principle gives rise.
- (b) The incremental cost of investment funds and trust funds must be interpreted in a variety of ways depending on the structure of the fund; for example, it was the additional cost of fund administration in the *Terra Capital* fund but the additional cost of individual subprojects in the *Small and Medium Enterprises* fund. In the *Small Grants Program*, in order to relieve the recipients of what are very small grants of the analytical burden of conceptualizing and calculating incremental cost for their small projects, the principle of incremental cost was applied only at the level of the overall program itself. The program managers mobilized other sources of finance, including from bilateral development cooperation agencies and the UN Foundation, and they make broad determinations of incrementality to ensure that overall GEF finances an amount commensurate with the global environmental objectives and that the cofinancing is adequate to fund the underlying development goals.
- (c) Biodiversity projects that embed a conservation objective into sustainable development are similar to the technology case. In one project example in southern Africa, incremental cost was the *additional* cost of veterinary fences and alternative livestock routes needed to protect arid or semi-arid vegetation that was important for biodiversity.
- (d) A 1998 project on preserving date palm varieties in the Maghreb highlighted the challenge of applying the incremental cost principle to agro-biodiversity: only costs associated with augmented action beyond national baselines would be funded. The sponsors of this project therefore recognized that much of the cost of preserving these varieties had to be financed locally as this action would produce benefits in their own country. Only the costs of going beyond this (in order to share benefits regionally) would be eligible for international financial support. Likewise, the costs of preserving species of immediate commercial interest should be financed commercially, but the costs of

maintaining intra-specific diversity through adding non-commercial species such as wild relatives or other low-yielding varieties are “incremental.” Also, the costs of sustaining protection of species beyond a reasonable payback time would also be eligible for support.

20. Focusing on complementarity has other benefits too: it creates an incentive to mobilize additional resources in support of the environmental objective and it provides a basis for financial coordination between a recipient country and donors. Incremental cost financing in particular requires proponents to think more strategically about a project proposal, i.e., to be explicit about what things will actually be different in their proposal from the normal course of events, and what the added costs will be.

SUSTAINABILITY

Trust funds

21. These are instruments that specifically aim to promote financial sustainability. This instrument has the advantage over regular project financing in that it can provide a very long timeline for its operations. Trust funds set aside assets whose use is legally restricted to specific uses. They can be structured as endowments, revolving funds, and sinking funds. Among the 77 funds that GEF has supported are an endowment fund for the Bwindi Impenetrable National Park and Mgahinga Gorilla National Park in Uganda. The policy of that fund is to devote 60 per cent of its endowment income to sustain the development of alternative livelihood activities in surrounding communities. Revolving funds in Vietnam and Lebanon are used to finance access to high quality seeds and to benefit communities living near protected areas respectively.

22. A recent GEF evaluation³ noted the main accomplishments of the trust fund instrument as:

- (a) Providing a basic resource security for operating protected areas;
- (b) Generating and managing financial resources over a long time period;
- (c) Encouraging the participation of civil society institutions;
- (d) Increasing scientific research applied to conservation issues;
- (e) Improving public awareness of conservation issues.

23. While there is still some uncertainty about the long-term conservation impact of trust funds, it is clear that they provide more continuity than project financing instruments. The evaluation identified the factors important for establishing a trust fund and those for successful trust fund operations.

³ *Experience with Conservation Trust Funds*, GEF, 1999

User charges

24. These constitute another way to ensure financial sustainability. They are used for example in Ecuador in a GEF-supported program to control invasive species in the Galapagos Archipelago and in a GEF conservation project in Maluku, Indonesia. Perhaps the most systematic and innovative approach has been in GEF's Costa Rica *Ecomarkets* project, implemented by the World Bank. This project is fostering conservation and sustainable use of forest biodiversity in Costa Rica through conservation easements on privately owned lands outside protected areas in the Mesoamerican Biological Corridor. It does so by establishing markets for, and private sector suppliers of, forest ecosystem environmental services. The project specifically supports payments of user charges to landowners who generate these environmental services -- including habitats for globally significant biodiversity (for which the GEF makes grants), watershed services (for which certain downstream water users pay), and carbon sequestration (for which other pilot funding is available).

Revenue generation

25. Creating revenue-generating activities ensures sustainability not only by securing finance but also by creating shared commitment to project activities. Some examples: There is a palmetto harvesting activity in a project GEF is supporting in Venezuela for the conservation of biodiversity of the Orinoco Delta Biosphere Reserve and Lower Orinoco Basin. Alternative revenue generation is important here as these wetlands are being threatened by economic activities such as hunting, extraction of minor forest products, agricultural expansion, and destructive fishing. Tourism and ecotourism can often provide such alternative revenue generation too, for example in the Maluku project mentioned above. Bee keeping, honey production, and handicrafts are part of an Africa regional project to manage indigenous vegetation for the rehabilitation of degraded arid rangelands. Revenues from controlled hunting are being directed to village conservation funds as part of the *Mountain Areas Conservancy* project in Pakistan – where these funds have already been tapped to bring clean drinking water to a village from a nearby glacier.

LEVERAGE

26. In the last decade, global economic growth and privatization have enormously increased the influence of private sector activities on the global environment. Another important reason to engage the private sector⁴ is the additional resources that can potentially be leveraged, through appropriate international financial instruments for environmental purposes such as the promotion of renewable energy and the control of global pollutants. Leveraging private sector resources though poses a number of unique challenges for the design of financial instruments:

- (a) How to finance activities without distorting markets;
- (b) How to be open to all firms and not pre-selecting “winners”;
- (c) How to determine the level of financial support required while maintaining commercial confidentiality;

⁴ For discussion of these instruments see *Engaging the Private Sector in GEF Activities*, GEF/C.13/Inf.5

- (d) How to identify and finance only “incremental” costs associated with global environmental action without adding to profits or underwriting normal commercial risks; and
- (e) How to respond with the timeliness and predictability typical in the relevant market.

27. Underwriting only the specific risks of the environmentally friendly technologies and methods has the advantage of not subsidizing technologies and methods that are in fact economic. GEF has attempted to do this through various contingent loan or contingent grant instruments.

Contingent grant/loan guarantee

28. A contingent grant, unlike a conventional grant, is repaid if the project is successful – otherwise the funds that had been paid out become a grant. The project proponent views such a grant as a short-term unsecured loan that is included in total project costs. This can be visualized through a few examples:

- (a) In Thailand, GEF provided a contingent interest-free loan through the World Bank to finance a 24-unit demonstration program to replace energy inefficient CFC-based building chillers with more efficient ozone-friendly ones. (Cofinancing was obtained from the Multilateral Fund of the Montreal Protocol with respect to the objective of phasing out the ozone depleting substances.)
- (b) In a UNDP-implemented GEF project in Malaysia for biomass power generation and cogeneration in the palm oil industry, GEF supported the application of guarantees developed by local financial and banking institutions.
- (c) GEF has also supported several projects to establish energy service companies, or ESCOs, where it is typical for the ESCO to guarantee repayable loans to end-users for energy efficiency products that are financed out of future energy savings.

29. Recently reviewed⁵ GEF projects implemented through the IFC demonstrate how resources can be applied towards reducing “incremental risk” associated with energy efficiency activities, and provide strong examples for the private sector. The IFC-implemented *Efficient Lighting Initiative* (ELI) is seen as a partnership project that seeks a long-term and sustained impact on markets, obtained by increasing demand, accessibility of capital, product availability, and competition so as to produce downward pressure on prices. The program – while being implemented in seven countries (Argentina, Czech Republic, Hungary, Latvia, Peru, Philippines and South Africa) benefits from cross-fertilization from a global set of principles, facilitated by an ELI

⁵ *Program Performance Review 2001*, GEF.

toolkit. One of the highlights of ELI is a monitoring and evaluation function that is integrated into program implementation. ELI has leveraged substantial in-kind and direct investments from utility and lighting industry companies.

Contingent loan

30. A contingent loan differs from a contingent grant in that a loan is treated as debt and therefore has a higher repayment priority than a contingent grant. (A grant is treated as project equity or an asset unless another arrangement is negotiated.) A contingent loan is repaid on a similar schedule and with a similar interest to other loans. Like a contingent grant though, it would be forgiven if the project fails. One illustration of this is the investment component of an ADB project in China for wind power development. This incorporates a GEF-financed contingent loan to address two key barriers for commercial wind investments in China: higher transaction costs for initial investments in the Xinjiang, Lianing, and Heilongjiang regions and the perceived risks of wind technology. A contingency has been introduced to share specific risks associated with wind resource availability and turbine performance. Current feasibility data suggest a sufficient return to enable the wind farms to operate on a fully commercial basis and therefore it is expected that the GEF loan will be repaid along with the ADB-provided debt. Only if the resource and technology performance remain significantly behind feasibility forecasts and lead to incremental economic costs would the GEF loan be partially or fully forgiven.

31. In the contingent instruments, the objective is to make a grant only in circumstances where the realized costs of the alternative exceed those of the baseline technology or approach. These instruments are still experimental; paradoxically, much of the challenge is to refine the legal and financial systems in the executing agencies in order to make these transactions (namely to isolate the specific technical risks that are being underwritten from any others, and to develop the legal instruments for invoking the guarantee or recovering a grant or loan made contingently). This approach though has enormous promise, as it would expand the range of situations under which international environmental finance could be accessed in developing countries by the private sector and vastly increase the leverage of grant finance.

Performance grant

32. This type of grant would be provided on the basis of completion or satisfaction of certain milestones. A contingent grant and a performance grant could be combined so that a sponsor receives funds on completion of certain milestones (performance) and funds could be forgiven if the project is not successful (contingent).

Partial credit guarantees

33. Partial credit guarantees are used to extend the maturity of commercial loans for projects and provide sponsors with improved cash flow during project life. They do not address risks that jeopardize cash flow, but rather provide an overall enhancement to the project's economics by covering general credit risk during a particular phase of the project. For example, GEF's *Hungary Energy Efficiency Co-financing Program* (HEECP), which was implemented by the IFC, provided an incentive for commercial banks to make loans for energy efficiency investments, at the time a new area of business

for Hungarian Banks. The incentive took the form of a loan guarantee covering up to 50 percent of the loans made at commercial rates to energy service companies (ESCOs) or to end users in the public and private sector for energy efficiency enhancement investments. In one subproject, recently visited by the team for the Second Overall Performance Study of the GEF, a private ESCO – Kipcalor – won a bid to design, build, and operate a new heating and cooling system for the Semmelweis Medical University teaching hospital in Budapest on the basis of the GEF-guaranteed loan. The new computer-controlled energy system for the 27-building hospital complex, cuts energy used for heating and cooling by 40 to 45 per cent while meeting the needs of the buildings. The energy savings pay for the project and Kipcalor expects its investment to break even within a few years. The success of this instrument is shown by the fact that, following the successful demonstrations in this program, a local district utility established its own guarantee program for its customers based on the project model and is utilizing its own resources, replacing an earlier program where the utility provided grants to its customers for insulation upgrades. Overall, IFC staff estimate that the project will spend less than 5 percent of the GEF funds committed to loan guarantees. Based on these estimates, the loan guarantee approach will end up providing commercial co-financing 20 times the initial support from GEF.

Alternative bankable feasibility studies

34. Another cost-effective way to increase the number of successful private sector experiences is to concentrate on the front-end of investment through financing alternative feasibility studies of the environmentally friendly alternative on a contingent basis. That has the advantage of leaving the private sector free to respond to the financial incentives that those studies reveal. The Organization of American States, for example, has provided \$100 million in bankable studies over 30 years that identified \$4 billion in investments to protect the environment, among which \$2 billion worth of projects were implemented. The UNEP-implemented GEF project *Redirecting Commercial Investment Decisions to Cleaner Technologies* project is an example of upfront support for “soft” business costs instead of capital subsidy to deal with barriers to entry of commercially viable transactions. The Investment Advisory Facility established in 1999 under this project provides banks and financiers with targeted expertise and support to evaluate proposals in the sustainable energy sector and to help these institutions develop the skills to evaluate such projects independently. That facility has supported 11 investment evaluations at a cost of about \$340,000 to the project. The gross value of these proposed investments is about \$218 million. It is hoped that at least 30 percent of these proposed investments be realized.

Progressive partnership

35. A “progressive partnership” is a direct collaboration with a company or business association that shares risks and project costs. These projects also offer creative roles for NGOs. An example from the GEF project portfolio is the *Papua New Guinea Biosphere Reserve in the Ramu River Catchment Area*, which the World Wildlife Fund has listed among the 200 most important ecoregions in the world. The project would create a commercial-scale demonstration of innovative approaches to resource management based

on a model partnership between The Nature Conservancy and a local private-sector partner.

GEF's *Marine Electronic Highway* project supports a marine navigation system that would minimize accidents and protect environmentally sensitive areas in the Malacca Straits region between Indonesia, Malaysia, and Singapore. With direction from the IFC, the World Bank, and the International Maritime Organization, a Canadian entrepreneur is providing follow-up with a venture capital partner. The project has the potential to serve as a model for protecting the marine environment that incorporates a user-pays financing mechanism.

36. Because of the site-specific, complex character of these projects, progressive partnerships may require additional time and resources. Over the longer term, such projects may effectively leverage GEF's resources and replicate results more cost-effectively and in a shorter time.

Private sector environmental investment funds

37. These funds have received grant or non-grant financing from GEF. The objective of this instrument is to provide commercial or quasi-commercial financing to subprojects through a fund manager, with a possible financial return on capital. Investment funds leverage a larger pool of commercial capital to invest in eligible projects, utilizing debt or equity as instruments as appropriate. GEF has considerable experience with these for-profit funds, e.g., *Renewable Energy and Energy Efficiency Fund*, *Small and Medium Scale Enterprise Program*, and *Terra Capital Biodiversity Enterprise Fund for Latin America* to name but a few. This is a very challenging instrument in terms of its responsiveness to national priorities; overall cost effectiveness taking into account all executing costs and management incentives; ability to sharply target global environmental objectives; and the incrementality of funding.⁶

38. Several funds have produced demonstration effects that have catalyzed further investments from the private sector in the innovative technologies and approaches that were introduced. One example is in Kenya where the only hire-purchase company that had decided to enter the photovoltaic sector with its own funding based on catalytic input provided by GEF's *Photovoltaic Market Transformation Initiative*, implemented by the IFC, has been successful. This has stimulated most of the large hire-purchase companies in Kenya to provide financing and support for solar home systems. Companies other countries in the region have also expressed interest in replicating some of the business models that are emerging from these projects.

CONCLUSION: LINKING THE MILLENNIUM DEVELOPMENT GOALS TO ACTION

39. Let me return to the GEF Roundtables and their recommendations for the World Summit on Sustainable Development, because the Summit presents a unique opportunity to ensure that environmental sustainability is fully and effectively integrated into actions designed to achieve the Millennium Development Goals. Broad statements of international principle will only become a reality through myriad concerted local actions.

⁶ For further discussion of these aspects see *Funds and Trust Funds*, GEF/C.12/Inf.5

The connection between international principle and action will be finance. It will be necessary to mobilize new and additional resources, possibly through innovative financial arrangements. It will also be necessary to use such funds effectively, and for this reason continued attention to effective international environmental financial instruments will be needed.